

# What Europe must do to boost its competitiveness and productivity

**With Europe at a crossroads, these are the barriers to a truly integrated capital market and how to build a more perfect union.**



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As Europe grapples with questions about its economic standing and future growth, two issues come up, as underscored by the Draghi Report: competitiveness and productivity.

At the [20th Banking Industry Meeting](#) hosted by IESE Business School in Madrid, professor [Mireia Giné](#) spoke with economist Vitor Constancio, former Vice President of the European Central Bank, to explore what's really behind the widening gap with the U.S. and what can realistically be done about it. They dig into the data and discuss the barriers to building a truly integrated capital market.

Here is a pragmatic view on where Europe stands and the steps it must take to remain relevant in an increasingly multipolar economic world.

**Mireia Giné: In the current debate on why Europe may be lagging on different metrics, we hear two concepts being used almost interchangeably: competitiveness and productivity. Can you unpack these concepts for us?**

**Vitor Constancio:** When economists talk about competitiveness, they're talking about international or external competitiveness. The OECD defines a competitive economy as one that is growing in a context of total openness, both in terms of trade and capital flows, while maintaining macroeconomic equilibria. In this sense, Europe is competitive. We also have a current account surplus and a lower budget deficit than the U.S., so that also makes us competitive, more than the U.S.

However, when the media or politicians talk about competitiveness, they talk in sportive terms — who's first, second or third, like a race. And what counts here is GDP per capita and productivity levels. The [Draghi Report on EU Competitiveness](#) is fundamentally about how to increase European productivity, because we are already competitive in the prior sense.



Vitor Constancio (pictured), an economist and professor at the University of Navarra, is former Governor of the Bank of Portugal (1985-1986 and 2000-2010) and former Vice President of the European Central Bank (2010-2018).

## **Is Europe really performing that much worse than the United States?**

**MG: So let's talk about productivity and income levels. One chart shows that in 2008, income per capita in the EU was 90% of what it was in the U.S., yet by 2023 it was 54% of the U.S. What happened for our living standards to drop so much?**

**VC:** Let me give a warning about comparing levels: That chart uses market exchange rates, which are not an accurate reflection of actual levels. To really compare levels, we have to use purchasing power parity (PPP), which takes a common basket of goods and services, and compares how much the same basket costs in different countries relative to their value in local currencies. That removes the distortion of exchange rate fluctuations. Doing that, we see we are more or less 25% below the U.S. in terms of income per capita. Likewise, when we talk about productivity, we should also use the PPP standard. Again, we see that in 2019,

before the pandemic, Europe was around 90% of the U.S. in terms of productivity per hour.

**MG: So PPP gives us a slightly more moderate or less pessimistic view on European productivity. But now we are in 2025 and it looks like, in terms of GDP per capita, Europe has dropped to 77% of the U.S. Why is that?**

**VC:** Well, the first thing is that we work less than the Americans. We have 30 days' holidays — an entire month — per year that Americans don't have. They only have 15 days, if that. So that fact alone makes the productivity per person below the U.S.

Next, the level of employment among our working age population is lower, and our working age population relative to total population is also lower and declining, whereas in the U.S. it is still growing. That's a demographic structure that we cannot change overnight.

These factors partly explain our lower GDP per capita, and why, in the sportive terms of competitiveness as a race, we are not in first place.

Granted, some of it is by choice — a legitimate choice of how much we want to work as a society. In Europe, there's a societal preference for leisure instead of more consumption. We care about environmental goals, and we care more about social cohesion. These are good values, but we do pay a price in terms of productivity.

**MG: We have this idea that the U.S. is always growing, but we in Europe are always lagging behind. You help put things in perspective, but it's not the whole story, is it? Demographics and social preferences don't explain everything.**

**VC:** No, because besides productivity and income levels, there are rates of growth, and here is where I will issue two warnings. First, our rates of growth are lagging behind, which, of course, in the future, will affect productivity and income levels. The second warning is that we have structural gaps, which are very difficult to overcome, if it is even possible to overcome them.

**MG: What are these structural gaps?**

**VC:** I will highlight four. First are the demographics I mentioned, which makes our growth prospects adverse compared with the U.S. Second is our degree of innovation. If we look at the number of patents coming out of Europe versus the U.S., there's a huge gap. Then we have the size of our firms, which are generally much smaller. And that's important, because we know from studies that larger firms tend to have higher levels of productivity. Fourth, we

lost the '90s race for information and communication technologies (ICT) while the ICT sector in the U.S. has exploded. That is a very difficult gap to overcome. Both the [Draghi Report](#) and the [European Commission's Competitiveness Compass](#) are largely about trying to overcome the gaps in these areas.

## Reducing Europe's market fragmentation

**MG: In talking about Europe's smaller firms being suboptimal for higher levels of productivity and innovation, this reflects another of the endemic barriers in the EU market. Some argue that our regulatory differences and fragmented national rules keep the EU from operating as a true single market, creating the equivalent of a trade barrier for businesses within the EU. The [IMF estimates](#) that these internal frictions are comparable to a tariff of 44% for goods and 110% for services. What's your view?**

**VC:** We do have too much fragmentation because we have not fully realized the single market nor have we completed a banking union. However, I find those IMF estimates to be a total exaggeration. Their so-called [gravity model](#) uses variables and makes assumptions that, at best, are a very gross approximation. There is no 44% equivalent tariff between our countries, I can assure you.

There is a [famous study by the economist John McCallum](#) in which he studied trade flows between Canada and the U.S. At the time, there was practically no border between Canada and the U.S. so according to gravity model forecasting, trade levels between Canada and the U.S. should be more or less the same as trade between states and provinces within each country. Yet what McCallum found was that Canadians very close to the U.S. border traded among themselves 20 times more than they traded with their American neighbors just on the other side of the border. What does that tell you? While total economic rationality might tell you there should be no nations, just markets, the reality is that nations count.

So, those IMF estimates should not discourage us — they're estimates based on economic theories. The fact is, the single market exists, and if we compare the level of trade now with what it was before the single market, it has been a success. Still, we know that national borders matter, and we know we need to make progress on reducing market fragmentation.

**MG: What do you think could realistically be done to decrease this fragmentation? What are the key steps or the main roadblocks?**

**VC:** I am confident that the European Commission's ideas to improve the single market — creating common standards and lowering barriers — will improve trade flows. The bigger problem I see is our lack of a capital markets union. That's the fragmentation we should and must correct now, in my view.

**MG: Does the European Commission's call for a [savings and investment union](#) help to address that?**

**VC:** It's insufficient. Personally, I think it's a step backward in ambition. Although what the Commission is proposing is positive, it's not a real unification of capital markets in Europe — not of the equity market or of the bond market.

The equity market is vital because it's a way to promote innovation, and that's crucial. Who made the Metas, the Apples, the Microsofts and the SpaceX's in the United States? It was the existence of a venture capital sector that could rely on making risky bets, where they could afford to lose money on some projects, knowing that those losses would be offset by being successful in half a dozen other projects, and being able to do IPOs in a deep, liquid capital market.

We don't have such a deep, liquid capital market in Europe, and we need it. Brussels knows this, but while they may accept the need for a pan-European equity market, they are concentrating less on the bond market — yet both are necessary.

## **A pan-European bond market as a safe alternative to the dollar**

**MG: Why is a pan-European bond market so important?**

**VC:** First is seeing what is happening under Trump — the waning confidence and growing suspicions that are developing internationally around the dollar. We would benefit from having a pan-European bond market the size of 6-7 trillion instead of the roughly 2 trillion we have now. Our financing in terms of debt instruments would become more financially independent from the dollar-based system, allowing us to promote the international role of the euro as a safe asset. A safe alternative to the dollar would facilitate the transition to a multicurrency, multiborrower system, which would be beneficial for the international monetary system.

Moreover, having a sizable bond market reduces the risk of the "[doom loop](#)," because banks

could invest in those European safe assets and not in domestic bonds. That's a big gain in terms of financial stability. It would also give us a "convenience yield advantage," which means that if we have a big, deep, liquid market, our cost of debt would become slightly cheaper.

**MG: So those are the advantages of a capital markets union. What are the obstacles to making it happen?**

**VC:** It's mainly national governments, which have not taken, nor do they seem to want to take, the necessary measures to harmonize the stock listings and taxation of financial products across national regimes. We need, for instance, automatic listings in all European exchanges, instead of the system we have now. In Europe, we have 35 national stock exchanges; the U.S. has 13. We have some group exchanges, but the groups operate in each country differently because regulations are different and taxation is different in each country. This means listings even for the same company are listed differently in each country. This should not happen. The technostucture of national exchanges works strongly against unification.

In the bond market, the difficulty is that, to have a European safe asset, we would need mutualization of debt — each country would have to be responsible for the debt of others. Of course, richer countries don't want that. A proposal was put forward to achieve the possibility of creating a European safe asset through a system of seniority, without implying mutualization, but it was rejected. We understand this is a sensitive area, but there's no denying we should have it.

The world has changed. Just as we can no longer rely on the defense umbrella of the U.S., we cannot rely on the dollar-based system as it was operated by the U.S. until now. We must act.

**MG: But it requires a lot of political will, which, as you say, is lacking.**

**VC:** But it's no harder than what we managed to do with our currencies. I mean, is there no greater symbol of national sovereignty than having your own currency, and yet we were able to pull off a monetary union. A capital markets union should be less difficult and would bring so many benefits. But it involves breaking some existing technostuctures and taboos.

**MG: As an insider, how hopeful are you that these reforms will ultimately be implemented?**

**VC:** If you read the European Commission's Competitiveness Compass, you see that it waters

down some of the reforms that would be necessary, like the ones I've mentioned, partly for reasons of political realism. We must be aware that what's currently on the table isn't enough.

I am absolutely convinced we know what we have to do, and it could be done, but the problem right now is political — and geopolitical. The current state of our national political systems is making decision-making at the pan-European level much more difficult. That being said, in 2023 the big concern was whether Europe could reduce inflation without falling into a major recession, and look what happened: we only had a shallow technical recession and returned to stronger than expected growth in 2024. So you never know. I'd like to remain optimistic, not so much for political reasons but for economic reasons, because there we know what we should do.

*IESE Prof. Mireia Giné discussed European Competitiveness with Vitor Constancio at the [20th Banking Industry Meeting](#) held at IESE Madrid in June 2025.*

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## **Mireia Giné**

Professor of Financial Management at IESE Business School. She specializes in corporate governance, shareholder activism, M&As, executive compensation and fintech.

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